

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input checked="" type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name Village of Shelby	County Oceana
Audit Date 2/28/06	Opinion Date 7/5/06	Date Accountant Report Submitted to State: 8/21/06	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

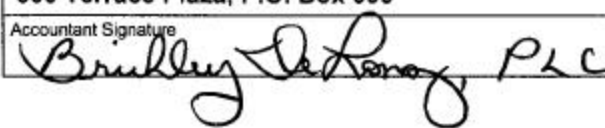
We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☒ Yes ☐ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGR).			✓

Certified Public Accountant (Firm Name) Brickley DeLong, PLC			
Street Address 500 Terrace Plaza, P.O. Box 999		City Muskegon	State MI
		ZIP 49443-0999	
Accountant Signature 		Date 8/21/06	

Village of Shelby
Oceana County, Michigan

REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)

Year ended February 28, 2006

Village of Shelby
LIST OF ELECTED AND APPOINTED OFFICIALS
February 28, 2006

ELECTED OFFICIALS

Jack Cheever	Village President
Ross Field	President Pro-Tem
Bill Glover	Council Member
Steve Lessens	Council Member
Pat Morningstar	Council Member
Andrea Garcia	Council Member
Wayne Tanner	Council Member
Kelly Bantien	Clerk
Yolanda Estrada	Treasurer

APPOINTED OFFICIALS

Sandy Dean	Deputy Clerk/Bookkeeper
Randal Phillips	Superintendent of Public Works

Village of Shelby

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As management of the Village of Shelby, we present to the readers of the Village's financial statements this overview and analysis of the financial activities of the Village for the fiscal year ended February 28, 2006. We encourage you to consider the information presented in these financial statements along with the additional information that has been furnished in this letter.

FINANCIAL HIGHLIGHTS

- Total net assets of all governmental activities increased by \$104,346.
- The General Fund fund balance increased by \$4,981.
- The net assets in the Water Fund increased by \$74,297.
- The net assets in the Sewer Fund increased by \$43,866.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis is intended to serve as an introduction to the Village's basic financial statements. The basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide Financial Statements

The government-wide financial statements are designed to provide the reader with a broad overview of the Village's finances. These statements are similar to those of a private sector business.

The Statement of Net Assets presents information on all of the Village's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Village is improving or deteriorating.

The Statement of Activities presents information showing how the Village's net assets changed during the fiscal year. All changes in net assets are reported when the event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in the future fiscal periods.

Both of the government-wide financial statements mentioned above distinguish functions of the Village that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are designed to recover all or a significant part of their costs through user fees and charges for services (business type activities). The governmental activities of the Village include general government, public safety, public works, and cultural and recreational activities. The business-type activities of the Village include water and sewer services.

Fund Financial Statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Village, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Village can be divided into three categories-governmental funds, proprietary funds and fiduciary funds.

Governmental Funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. This information may be useful in evaluating a governmental entity's short-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's short-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison.

The Village maintains four individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for all four funds as they are all considered major funds.

Proprietary Funds. The Village has two enterprise proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The Village uses enterprise funds to account for its water distribution and sewer operations.

Enterprise funds provide the same type of information as the government-wide financial statements, only in more detail. The enterprise funds financial statements provide separate information for the Water and Sewer funds, both of which are major funds.

Fiduciary Funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the Village. Fiduciary funds are not reflected on the government-wide financial statements because the resources from those funds are not available to support the Village's programs. The accounting method used for fiduciary funds is much like that used for the proprietary funds.

Notes to the Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The reader is encouraged to include the reading of this section in any attempt to analyze and understand these statements.

Other Information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the Village's budgetary information as it relates to the actual expenditures for the General Fund, Major Streets Fund and Local Streets Fund.

Government-wide Financial Analysis

The first table presented below is a summary of the government-wide statement of net assets for the Village. As stated earlier, the net assets may be used as an indicator of a government's financial health. As of February 28, 2006, the Village's net assets from governmental activities totaled \$3,412,141 (59%) and \$2,432,218 (41%) from business-type activities, creating a total government-wide net assets total of \$5,844,359.

In examining the composition of these net assets, the reader should note that governmental activities net assets are invested in capital assets (i.e., streets, buildings, land, vehicles, equipment, etc.) These assets are used to provide services to the Village's residents, and they are not available to pay salaries, operational expenses or fund capital projects. The unrestricted net assets for governmental activities actually depict a balance of \$913,121. This represents the amount of discretionary resources that can be used for general governmental operations.

For governmental activities, growth in current assets is comparable to growth in unrestricted and restricted net assets. Restricted net assets are legally restricted for streets and debt service. Decreases in capital assets and noncurrent liabilities are attributable to regular depreciation expense and scheduled debt payments, respectively.

The business-type activities show a total of \$2,432,218 in net assets and \$546,467 in unrestricted net assets. The Sewer Fund and Water Fund unrestricted net assets are \$1,070,143 and \$1,369,107, respectively.

For business-type activities, capital assets and invested in capital assets, net of related debt, increased as a result of preliminary engineering work being done for sewer plant improvements.

Net Assets

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Current assets and other assets	\$ 1,945,275	\$ 1,793,520	\$ 607,595	\$ 626,263	\$ 2,552,870	\$ 2,419,783
Capital assets	2,983,389	3,070,841	3,085,751	2,963,258	6,069,140	6,034,099
Total assets	4,928,664	4,864,361	3,693,346	3,589,521	8,622,010	8,453,882
Current liabilities	151,116	109,700	121,128	70,117	272,244	179,817
Noncurrent liabilities	1,365,407	1,446,866	1,140,000	1,200,000	2,505,407	2,646,866
Total liabilities	1,516,523	1,556,566	1,261,128	1,270,117	2,777,651	2,826,683

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Net assets						
Invested in capital assets, net of related debt	\$ 1,581,882	\$ 1,621,141	\$ 1,844,136	\$ 1,717,439	\$ 3,426,018	\$ 3,338,580
Restricted	917,138	799,728	41,615	28,851	958,753	828,579
Unrestricted	913,121	886,926	546,467	573,114	1,459,588	1,460,040
Total net assets	\$ <u>3,412,141</u>	\$ <u>3,307,795</u>	\$ <u>2,432,218</u>	\$ <u>2,319,404</u>	\$ <u>5,844,359</u>	\$ <u>5,627,199</u>

Governmental Activities

Net assets of governmental activities increased by \$104,346 (3.2%) during the 2006 fiscal year. Grants and contributions not restricted declined due to cuts in state shared revenue. The gain on sale of assets is related to the trade in of some equipment. Interest on long-term debt decreased due to timing issues. The following table shows these results.

Business-type activities

At the end of the fiscal year, the net assets for business-type activities increased by \$112,814 (4.9%). Charges for services increased due to utility rate increases. Water Fund expenses increased due to the Village beginning a meter replacement program. The following table shows these results.

Change in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenues:						
Program revenues						
Charges for services	\$ 34,881	\$ 28,201	\$ 453,740	\$ 384,917	\$ 488,621	\$ 413,118
Operating grants	204,358	210,593	7,257	-	211,615	210,593
Capital grants	-	-	3,815	-	3,815	-
General revenues						
Property taxes	497,360	498,879	-	-	497,360	498,879
Grants and contributions not restricted	218,944	246,931	-	-	218,944	246,931
Unrestricted investment earnings	27,783	32,016	9,305	6,692	37,088	38,708
Miscellaneous	9,730	8,925	12,587	25,322	22,317	34,247
Gain on sale of capital assets	45,343	-	-	-	45,343	-
Total revenues	1,038,399	1,025,545	486,704	416,931	1,525,103	1,442,476

Management's Discussion and Analysis

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Expenses:						
General government	\$ 89,738	\$ 78,590	\$ -	\$ -	\$ 89,738	\$ 78,590
Public safety	257,891	229,623	-	-	257,891	229,623
Public works	534,647	532,444	-	-	534,647	532,444
Culture and recreation	24,397	19,338	-	-	24,397	19,338
Interest on long-term debt	27,380	116,238	-	-	27,380	116,238
Sewer Fund	-	-	115,290	86,931	115,290	86,931
Water Fund	-	-	258,600	200,373	258,600	200,373
Total expenses	<u>934,053</u>	<u>976,233</u>	<u>373,890</u>	<u>287,304</u>	<u>1,307,943</u>	<u>1,263,537</u>
Change in net assets	104,346	49,312	112,814	129,627	217,160	178,939
Net assets - Beginning	<u>3,307,795</u>	<u>3,258,483</u>	<u>2,319,404</u>	<u>2,189,777</u>	<u>5,627,199</u>	<u>5,448,260</u>
Net assets - Ending	<u><u>\$ 3,412,141</u></u>	<u><u>\$ 3,307,795</u></u>	<u><u>\$ 2,432,218</u></u>	<u><u>\$ 2,319,404</u></u>	<u><u>\$ 5,844,359</u></u>	<u><u>\$ 5,627,199</u></u>

Financial Analysis of the Government's Funds

As stated earlier in this discussion and analysis, the Village uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds. The focus of the Village's governmental funds is to provide information on near-term inflows, outflows, and balances in spendable resources. Such information is useful in assessing the Village's financing requirements. In particular, unreserved fund balances or the lack thereof, may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At the end of the 2006 fiscal year, the Village governmental funds reported a combined fund balance of \$1,627,881. This number represents fund balance of \$710,743 in the General Fund and \$917,138 in other governmental funds. It is necessary to further distinguish between the unreserved and reserved fund balance. The unreserved balance represents what is available for spending at the Village's discretion. The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has already been committed to pay debt service of \$96,338.

Proprietary Funds. The Village's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. Net assets of the Sewer and Water funds increased by \$43,866 and \$74,297, respectively. The result was an overall net increase in the proprietary funds of \$118,163.

General Fund Budget

During the current fiscal year, the Village did not make any amendments to the original revenue budget and only made a few minor reclassifications to the original expense budget that did not change total expenses.

The following comments summarize the major variations from the final budget to actual revenues and expenditures.

- Actual property taxes were over budget by \$20,486. This difference occurred because the Village was conservative in budgeting growth in taxable value.
- Actual public works expenses were under budget by \$27,561. The difference occurred because funds budgeted for contracted services and sidewalks were not spent. In addition, the final allocation of health insurance costs between departments was less than budgeted.
- Actual parks expenses were under budget by \$15,281. This difference occurred because all budgeted projects did not occur. In addition, the final allocation of health insurance costs between departments was less than budgeted.

Capital Assets Administration

The Village's investment in capital assets for its governmental and business-type activities as of February 28, 2006 totaled \$5,956,228 (net of accumulated depreciation). This investment in capital assets includes land, buildings, infrastructure, improvements, machinery, equipment, plants and vehicles.

Major capital asset events during the current fiscal year included the following:

- A loader and backhoe were purchased for \$111,420.
- Construction was begun on a new salt shed for \$9,880.
- Preliminary work was begun on sewer plant improvements for \$111,923.

Capital Assets (Net of Accumulated Depreciation)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Land	\$ 295,593	\$ 294,828	\$ -	\$ -	\$ 295,593	\$ 294,828
Construction in progress	9,880	-	111,923	-	121,803	-
Buildings and improvements	62,719	73,697	-	-	62,719	73,697
Vehicles and equipment	261,190	248,274	-	-	261,190	248,274
Infrastructure	2,304,239	2,454,042	2,910,684	2,963,258	5,214,923	5,417,300
Total	<u>\$ 2,933,621</u>	<u>\$ 3,070,841</u>	<u>\$ 3,022,607</u>	<u>\$ 2,963,258</u>	<u>\$ 5,956,228</u>	<u>\$ 6,034,099</u>

Additional information on the Village's capital assets can be found in Note D of the "Notes to the Financial Statements" of this report.

Long-term debt. At the end of the 2006 fiscal year, the Village had total outstanding debt of \$2,705,407 consisting of general obligations bonds, revenue bonds and compensated absences. The general obligation debt of \$1,401,507 in governmental funds is backed by the full-faith and credit of the Village. \$1,200,000 of the Village's outstanding debt represented in table below is recorded as revenue bonds. The payment of this debt service is anticipated through the revenues generated from the water and sewer services in the enterprise funds.

Outstanding Debt

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
General obligation bonds	\$ 1,401,507	\$ 1,410,000	\$ -	\$ -	\$ 1,401,507	\$ 1,410,000
Compensated absences	103,900	106,866	-	-	103,900	106,866
Revenue bonds	-	-	1,200,000	1,255,000	1,200,000	1,255,000
Total	<u>\$ 1,505,407</u>	<u>\$ 1,516,866</u>	<u>\$ 1,200,000</u>	<u>\$ 1,255,000</u>	<u>\$ 2,705,407</u>	<u>\$ 2,771,866</u>

The Village's total debt decreased by \$66,459 during the fiscal year. This reduction was due to normal debt payoffs as provided for in the fiscal year 2006 budget, offset by the effects of an advance refunding. The Village advance refunded a portion of its general obligation bonds in the governmental activities. The refinancing increased the amount of debt by \$110,000, but it will reduce total debt service payments by over \$102,000 and result in an economic gain of over \$82,000.

Additional information on the Village's long-term debt can be found in Note G of the "Notes to the Financial Statements" of this report.

General Economic Overview

In future budgets the Village's finances may continue to dwindle as additional cuts in state revenue sharing are possible and the cost of providing services continues to rise.

In 2007, the Village will begin construction on needed improvements to the Wastewater Treatment Plant. The plant improvements will be done in two phases with completion anticipated in the fall of 2008. The estimates for these upgrades are approximately \$3.7 million dollars. The improvements will be financed with a Rural Development loan at 3.5 – 4.5% interest rate over a 40 year term. The Village is anticipating that it will receive approximately \$690,000 in grant money leaving \$3,010,000 to finance. The Village of Shelby is hopeful that it will be able to refinance the project using State Revolving Fund loans which currently carry a 2.25% interest rate for 20 years thus reducing interest costs to the Village.

Other future expenditures that the Village can expect may include rehab of the elevated water storage facility, replacement of old and undersized water mains, replacement and construction of sidewalks, improvements to the Village parks, tree planting, street maintenance and construction of new Village facilities.

The Village Board and staff remain optimistic that the Village's economic stability will be enhanced by several projects in various stages of development among them is the current housing project known as Northland Crossing's which will provide 13 new homes. The Northland Crossings project is nearing completion with all thirteen homes in various stages of construction. The Devonwood Drive Senior Condominium project has completed the infrastructure and street portion. Devonwood Drive has one unit finished and the developers are actively trying to sell additional units. A new development for the Village of Shelby called Barnett Station has been proposed as a multi-family apartment complex. Barnett Station has a goal of completing 49 units by the fall of 2007.

During the Village's budget process, it was recognized that further stabilization in revenues were needed in the water and sewer utilities. The water utility had a substantial increase in rates in 2001 and it appears, unless determined by an ongoing revenue review process, that no increase will be necessary until the 2008 fiscal budget. The sewer utility revenue review indicates that a rate increase is necessary as soon as possible. The rate increase is driven by several factors, (1) wastewater treatment plant upgrades, (2) rate reduction in 2001 and (3) summer discounts. The rate increased in October of 2005 from a ready-to-serve charge of \$11.50 to \$30.00 per quarter and the commodity charge from \$0.85 to \$1.50 per hundred cubic feet. This was the first of three increases anticipated. The amount of the second increase is still under discussion.

The Village of Shelby anticipates taking steps to offset the declining revenues by trying to stabilize the increasing cost of providing services to the community. Some of these steps to offset the declining revenues may include review of the current employee benefit plan, reducing the level of services or, if it becomes necessary, reducing the labor force. The result of these actions may be reflected in the 2007 final expenditures as adjustments are made, however, it should be noted that in some cases these actions may effectively only slow the rate of increase in expenditures but not actually reduce them.

Requests for Information

This financial report is designed to provide a general overview of the Village of Shelby's finances for all those with an interest. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Village of Shelby, P.O. Box 127, Shelby, Michigan 49455, (231) 861-4400.

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

July 5, 2006

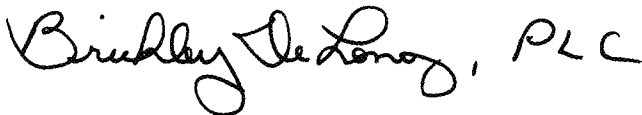
Village Council
Village of Shelby
Shelby, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Village of Shelby as of and for the year ended February 28, 2006, which collectively comprise the Village of Shelby's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Village of Shelby's management. Our responsibility is to express opinions of these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Village of Shelby, as of February 28, 2006, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and budgetary comparison information on pages i - viii and 26 - 28, are not a required part of the basic financial statement but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Village of Shelby
STATEMENT OF NET ASSETS
February 28, 2006

ASSETS

	Governmental activities	Business-type activities	Total
CURRENT ASSETS			
Cash and investments	\$ 1,728,512	\$ 523,620	\$ 2,252,132
Receivables	76,991	91,171	168,162
Due from other governmental units	92,740	-	92,740
Internal balances	47,032	(47,032)	-
Inventories	-	39,836	39,836
Total current assets	1,945,275	607,595	2,552,870
NONCURRENT ASSETS			
Restricted assets	-	41,615	41,615
Capital assets, net			
Nondepreciable	305,473	111,923	417,396
Depreciable	2,628,148	2,910,684	5,538,832
Bond issuance costs, net	49,768	21,529	71,297
Total noncurrent assets	2,983,389	3,085,751	6,069,140
Total assets	4,928,664	3,693,346	8,622,010
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES			
Accounts payable and accrued liabilities	11,116	61,128	72,244
Bonds and other obligations, due within one year	140,000	60,000	200,000
Total current liabilities	151,116	121,128	272,244
NONCURRENT LIABILITIES			
Bonds and other obligations, less amounts due within one year	1,365,407	1,140,000	2,505,407
Total liabilities	1,516,523	1,261,128	2,777,651
NET ASSETS			
Invested in capital assets, net of related debt	1,581,882	1,844,136	3,426,018
Restricted for:			
Streets and highways	820,800	-	820,800
Debt service	96,338	41,615	137,953
Unrestricted	913,121	546,467	1,459,588
Total net assets	\$ 3,412,141	\$ 2,432,218	\$ 5,844,359

The accompanying notes are an integral part of this statement.

Village of Shelby
STATEMENT OF ACTIVITIES
For the year ended February 28, 2006

<i>Functions/Programs</i>	Expenses	Program Revenue			Net (Expense) Revenue and Changes in Net Assets		
		Charges for services	Operating grants and contributions	Capital grants and contributions	Governmental activities	Business-type activities	Total
Governmental activities							
General government	\$ 89,738	\$ 34,881	\$ -	\$ -	\$ (54,857)	\$ -	\$ (54,857)
Public safety	257,891	-	-	-	(257,891)	-	(257,891)
Public works	534,647	-	204,358	-	(330,289)	-	(330,289)
Culture and recreation	24,397	-	-	-	(24,397)	-	(24,397)
Interest on long-term debt	27,380	-	-	-	(27,380)	-	(27,380)
Total governmental activities	934,053	34,881	204,358	-	(694,814)	-	(694,814)
Business-type activities							
Sewer	115,290	154,848	-	-	-	39,558	39,558
Water	258,600	298,892	7,257	3,815	-	51,364	51,364
Total business-type activities	373,890	453,740	7,257	3,815	-	90,922	90,922
Total government	\$ 1,307,943	\$ 488,621	\$ 211,615	\$ 3,815	(694,814)	90,922	(603,892)
General revenues							
Property taxes, levied for							
General purposes					295,486	-	295,486
Specific purposes					201,874	-	201,874
Grants and contributions not restricted to specific programs					218,944	-	218,944
Unrestricted investment earnings					27,783	9,305	37,088
Miscellaneous					9,730	12,587	22,317
Gain on sale of capital assets					45,343	-	45,343
Total general revenues					799,160	21,892	821,052
Change in net assets					104,346	112,814	217,160
Net assets at March 1, 2005					3,307,795	2,319,404	5,627,199
Net assets at February 28, 2006					\$ 3,412,141	\$ 2,432,218	\$ 5,844,359

The accompanying notes are an integral part of this statement.

Village of Shelby
BALANCE SHEET
Governmental Funds
February 28, 2006

	General Fund	Major Streets Fund	Local Streets Fund	Debt Service Fund	Total governmental funds
ASSETS					
Cash and investments	\$ 599,470	\$ 345,697	\$ 445,013	\$ 79,086	\$ 1,469,266
Receivables					
Property taxes	39,779	-	9,925	17,252	66,956
Other	10,035	-	-	-	10,035
Due from other governmental units	65,860	20,405	6,475	-	92,740
Total assets	<u>\$ 715,144</u>	<u>\$ 366,102</u>	<u>\$ 461,413</u>	<u>\$ 96,338</u>	<u>\$ 1,638,997</u>
LIABILITIES AND FUND BALANCES					
Liabilities					
Accounts payable	\$ -	\$ 3,156	\$ 3,559	\$ -	\$ 6,715
Accrued liabilities	4,401	-	-	-	4,401
Total liabilities	4,401	3,156	3,559	-	11,116
Fund balances					
Reserved for debt service	-	-	-	96,338	96,338
Unreserved, undesignated					
General Fund	710,743	-	-	-	710,743
Special revenue funds	-	362,946	457,854	-	820,800
Total fund balances	710,743	362,946	457,854	96,338	1,627,881
Total liabilities and fund balances	<u>\$ 715,144</u>	<u>\$ 366,102</u>	<u>\$ 461,413</u>	<u>\$ 96,338</u>	<u>\$ 1,638,997</u>

The accompanying notes are an integral part of this statement.

Village of Shelby
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
 TO THE STATEMENT OF NET ASSETS**
 February 28, 2006

Total fund balance—governmental funds		\$ 1,627,881
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Amounts reported for governmental activities in the Statement of Net Assets
are different because:

Capital assets used in governmental activities are not financial resources and
are not reported in the governmental funds.

Cost of capital assets	\$ 3,740,685	
Accumulated depreciation	<u>(1,068,254)</u>	2,672,431

Bond issuance costs are not capitalized and amortized in the governmental funds.

Bond issuance costs	55,714	
Accumulated amortization	<u>(5,946)</u>	49,768

Long-term liabilities in governmental activities are not due and payable in the
current period and are not reported in the governmental funds.

Bonds and notes payable	(1,401,507)	
Compensated absences	<u>(103,900)</u>	(1,505,407)

Internal service funds are used by management to charge the costs of certain activities
to individual funds. The assets and liabilities of the internal service fund are reported
with governmental activities in the Statement of Net Assets.

		<u>567,468</u>
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Net assets of governmental activities in the Statement of Net Assets		\$ <u><u>3,412,141</u></u>
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The accompanying notes are an integral part of this statement.

Village of Shelby
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
Governmental Funds
For the year ended February 28, 2006

	General Fund	Major Streets Fund	Local Streets Fund	Debt Service Fund	Total governmental funds
REVENUES					
Property taxes	\$ 295,486	\$ -	\$ 73,697	\$ 128,177	\$ 497,360
Intergovernmental revenues - state	218,944	144,965	43,232	-	407,141
Charges for services	34,881	-	-	-	34,881
Fines and forfeitures	3,540	-	-	-	3,540
Investment earnings	17,195	6,768	9,393	4,379	37,735
Other	6,092	98	-	-	6,190
Total revenues	576,138	151,831	126,322	132,556	986,847
EXPENDITURES					
Current					
General government	79,253	-	-	-	79,253
Public safety	255,594	-	-	-	255,594
Public works	212,209	74,335	83,742	-	370,286
Culture and recreation	23,336	-	-	-	23,336
Debt service					
Principal	-	25,000	-	45,000	70,000
Interest and fees	-	4,169	-	51,173	55,342
Bond issuance costs	-	-	-	55,714	55,714
Capital outlay	765	4,232	5,648	-	10,645
Total expenditures	571,157	107,736	89,390	151,887	920,170
Excess of revenues over (under) expenditures	4,981	44,095	36,932	(19,331)	66,677
OTHER FINANCING SOURCES (USES)					
Proceeds from refunding bonds	-	-	-	1,325,000	1,325,000
Premium on proceeds of refunding bonds	-	-	-	15,748	15,748
Payment to refunded bond escrow agent	-	-	-	(1,285,034)	(1,285,034)
Total other financing sources (uses)	-	-	-	55,714	55,714
Net change in fund balances	4,981	44,095	36,932	36,383	122,391
Fund balances at March 1, 2005	705,762	318,851	420,922	59,955	1,505,490
Fund balances at February 28, 2006	\$ 710,743	\$ 362,946	\$ 457,854	\$ 96,338	\$ 1,627,881

The accompanying notes are an integral part of this statement.

Village of Shelby
**RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES**

For the year ended February 28, 2006

Net change in fund balances—total governmental funds	\$	122,391
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Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report outlays for capital assets and bond issuance costs as expenditures; in the Statement of Activities, these costs are depreciated and amortized over their estimated useful lives, respectively.

Depreciation and amortization expense	\$	(166,727)	
Capital outlay		10,645	
Bond issuance costs		<u>55,714</u>	(100,368)

Debt proceeds are other financing sources in the governmental funds, but the proceeds increase long-term debt in the Statement of Net Assets.		(1,340,748)
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Repayment of principal on long-term debt is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.		1,349,241
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Interest expense on long-term debt is recorded in the Statement of Activities when incurred, but is not reported in the governmental funds until paid.		39,700
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Compensated absences are reported on the accrual method in the Statement of Activities and reported as expenditures when financial resources are used in the governmental funds.		2,966
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The internal service funds are used by management to charge the costs of certain activities to individual funds. The net change of the internal service funds is reported with governmental activities.		<u>31,164</u>
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Change in net assets of governmental activities	\$	<u><u>104,346</u></u>
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The accompanying notes are an integral part of this statement.

Village of Shelby
STATEMENT OF NET ASSETS
Proprietary Funds
February 28, 2006

ASSETS

	Business-type Activities - Enterprise funds			Governmental activities - Internal Service Fund
	Sewer	Water	Total	
CURRENT ASSETS				
Cash and investments	\$ 124,263	\$ 399,357	\$ 523,620	\$ 259,246
Accounts receivable	36,779	54,392	91,171	-
Inventories	2,376	37,460	39,836	-
Total current assets	163,418	491,209	654,627	259,246
NONCURRENT ASSETS				
Restricted assets	-	41,615	41,615	-
Capital assets, net				
Plants and systems	1,637,903	2,489,224	4,127,127	-
Equipment and furniture	-	-	-	548,812
Construction in progress	111,923	-	111,923	-
Less accumulated depreciation	(759,047)	(457,396)	(1,216,443)	(287,622)
Net capital assets	990,779	2,031,828	3,022,607	261,190
Advances to other funds	-	-	-	40,000
Bond issuance costs, net	-	21,529	21,529	-
Total noncurrent assets	990,779	2,053,357	3,044,136	301,190
Total assets	1,154,197	2,586,181	3,740,378	560,436
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accounts payable	44,054	4,574	48,628	-
Accrued liabilities	-	12,500	12,500	-
Bonds and other obligations, due within one year	-	60,000	60,000	-
Total current liabilities	44,054	77,074	121,128	-
NONCURRENT LIABILITIES				
Advances from other funds	40,000	-	40,000	-
Bonds and other obligations, less amounts due within one year	-	1,140,000	1,140,000	-
Total noncurrent liabilities	40,000	1,140,000	1,180,000	-
Total liabilities	84,054	1,217,074	1,301,128	-
NET ASSETS				
Invested in capital assets, net of related debt	990,779	853,357	1,844,136	261,190
Restricted for debt service	-	41,615	41,615	-
Unrestricted	79,364	474,135	553,499	299,246
Total net assets	\$ 1,070,143	\$ 1,369,107	2,439,250	\$ 560,436
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds			(7,032)	
Net assets of business-type activities			\$ 2,432,218	

The accompanying notes are an integral part of this statement.

Village of Shelby
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
 Proprietary Funds
 For the year ended February 28, 2006

	Business-type Activities - Enterprise funds			Governmental activities - Internal Service Fund
	Sewer	Water	Total	
REVENUES				
Charges for services	\$ 154,848	\$ 298,892	\$ 453,740	\$ 132,176
Other	10	19,834	19,844	368
Total operating revenues	154,858	318,726	473,584	132,544
OPERATING EXPENSES				
Operations and administration	93,432	178,507	271,939	107,919
Depreciation and amortization	19,827	44,722	64,549	50,363
Total operating expenses	113,259	223,229	336,488	158,282
Operating income (loss)	41,599	95,497	137,096	(25,738)
NONOPERATING REVENUES (EXPENSES)				
Investment earnings	2,267	7,038	9,305	6,210
Connection fees	-	3,815	3,815	-
Gain (loss) on sale of capital assets	-	(1,824)	(1,824)	45,343
Interest expense	-	(30,229)	(30,229)	-
Total nonoperating revenue (expenses)	2,267	(21,200)	(18,933)	51,553
Change in net assets	43,866	74,297	118,163	25,815
Net assets at March 1, 2005	1,026,277	1,294,810		534,621
Net assets at February 28, 2006	\$ 1,070,143	\$ 1,369,107		\$ 560,436
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds			(5,349)	
Change in net assets of business-type activities			\$ 112,814	

The accompanying notes are an integral part of this statement.

Village of Shelby
STATEMENT OF CASH FLOWS
Proprietary Funds
For the year ended February 28, 2006

	Business-type Activities - Enterprise funds			Governmental activities - Internal Service Fund
	Sewer	Water	Total	
CASH FLOWS FROM OPERATING ACTIVITIES				
Receipts from customers	\$ 142,543	\$ 324,207	\$ 466,750	\$ -
Receipts from interfund services provided	-	-	-	132,544
Payments to suppliers	(31,727)	(84,207)	(115,934)	(64,608)
Payments to employees	(47,297)	(65,142)	(112,439)	(31,311)
Payment for interfund services used	(14,408)	(26,055)	(40,463)	(12,000)
Net cash provided by operating activities	49,111	148,803	197,914	24,625
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Advances from other funds (net)	40,000	-	40,000	(40,000)
Connection fees	-	3,815	3,815	-
Purchases of capital assets	(67,869)	(12,500)	(80,369)	(111,420)
Principal paid on capital debt	-	(55,000)	(55,000)	-
Interest paid on capital debt	-	(31,376)	(31,376)	-
Proceeds from sale of capital assets	-	-	-	93,484
Net cash used for capital and related financing activities	(27,869)	(95,061)	(122,930)	(57,936)
CASH FLOW FROM INVESTING ACTIVITIES				
Investment earnings	2,267	7,038	9,305	6,210
Net increase (decrease) in cash and investments	23,509	60,780	84,289	(27,101)
Cash and investments at March 1, 2005	100,754	380,192	480,946	286,347
Cash and investments at February 28, 2006	<u>\$ 124,263</u>	<u>\$ 440,972</u>	<u>\$ 565,235</u>	<u>\$ 259,246</u>
Reconciliation of cash and investments to the balance sheet				
Cash and investments	\$ 124,263	\$ 399,357	\$ 523,620	\$ 259,246
Restricted assets	-	41,615	41,615	-
	<u>\$ 124,263</u>	<u>\$ 440,972</u>	<u>\$ 565,235</u>	<u>\$ 259,246</u>
Reconciliation of operating income (loss) to net cash provided by operating activities				
Operating income (loss)	\$ 41,599	\$ 95,497	\$ 137,096	\$ (25,738)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities				
Depreciation and amortization expense	19,827	44,722	64,549	50,363
Change in assets and liabilities				
Receivables, net	(12,315)	5,481	(6,834)	-
Accounts payable	-	3,103	3,103	-
Net cash provided by operating activities	<u>\$ 49,111</u>	<u>\$ 148,803</u>	<u>\$ 197,914</u>	<u>\$ 24,625</u>

The accompanying notes are an integral part of this statement.

Village of Shelby
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES
Fiduciary Funds
February 28, 2006

	<u>Agency Fund</u>
ASSETS	
Cash and investments	\$ <u>1,027</u>
LIABILITIES	
Deposits held for others	\$ <u>1,027</u>

The accompanying notes are an integral part of this statement.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Village of Shelby (Village) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Village's accounting policies are described below.

Reporting Entity

The Village is a municipal corporation governed by a seven-member council.

Generally accepted accounting principles require that if the Village has certain oversight responsibilities over other organizations, those organizations should be included in the Village's financial statements. Since no organizations met this criteria, none are included in the financial statements.

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the Village. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirement of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues. The Village does not allocate indirect costs.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Financial Statement Presentation—Continued

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The Village reports the following major governmental funds:

The General Fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The Major Street Fund and Local Street Fund account for money distributed by the State of Michigan for street maintenance.

The Debt Service Fund is used to account for principal and interest payments on the Village's general debt.

The Village reports the following two major proprietary funds:

The Sewer Fund operates the Village's sewage pumping station, collection systems, and treatment systems.

The Water Fund operates the Village's water distribution system.

Additionally, the Village reports the following fund types:

Internal service funds account for equipment management services provided to other funds of the government on a cost reimbursement basis.

Agency funds account for all assets held by the Village on behalf of others in a fiduciary capacity.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Government Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Village has elected not to follow subsequent private-sector guidance.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the Village's water and sewer function and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Financial Statement Presentation—Continued

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services or privileges provided, 2) operating grants and contributions and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues are charges to customers for sales and services. The enterprise funds also recognize as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the Village's policy to use restricted resources first, then unrestricted resources as they are needed.

Assets, Liabilities and Net Assets or Equity

Deposits and Investments

The Village's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

The Village reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Under this standard, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standard also provides that certain investments are valued at cost (or amortized cost) when they are of short-term duration, the rate of return is fixed, and the Village intends to hold the investment until maturity.

The Village has adopted an investment policy in compliance with State of Michigan statutes. Those statutes authorize the Village to invest in obligations of the United States, certificates of deposit, prime commercial paper, securities guaranteed by United States agencies or instrumentalities, United States government or federal agency obligation repurchase agreements, bankers acceptances, state-approved investment pools and certain mutual funds.

Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds". Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances".

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Assets, Liabilities and Net Assets or Equity—Continued

Receivables and Payables—Continued

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

All trade and property tax receivables are shown net of allowance for uncollectibles.

The Village bills and collects its own property taxes. Taxes are levied on each July 1 on the taxable valuation of property (as defined by state statutes) located in the Local Governmental Unit as of the preceding December 31. Uncollected real property taxes as of September 15 are turned over by the Village to the County for collection. The County advances the Village all these delinquent real property taxes. The delinquent personal property taxes remain the responsibility of the Village. The Village recognizes available revenue from the current tax levy. Available means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period (60 days).

The 2005 state taxable value for real/personal property of the Village totaled approximately \$26,607,000. The ad valorem taxes levied consisted of 10.952 mills for operating purposes, 2.7328 mills for local streets and 4.75 for debt service. These amounts are recognized in the respective General Fund, Local Streets Fund and Debt Service Fund.

Inventories

All inventories are valued at cost using the first-in/first-out(FIFO) method. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

Restricted Assets

Certain proceeds of the Enterprise Fund revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants.

Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Assets, Liabilities and Net Assets or Equity—Continued

Capital Assets—Continued

In the case of the initial capitalization of general infrastructure assets (i.e., those reported by governmental activities), the Village chose to include all such items regardless of their acquisition date or amount. The Village was able to obtain the historical cost of the initial reporting of these assets by recording the actual costs incurred by the Village.

Property, plant and equipment are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and improvements	40
Infrastructure	20
Plants and systems	20-80
Vehicles and equipment	5-10

Compensated Absences

Village employees are granted vacation and sick leave in varying amounts based on length of service. Accumulated vacation must be taken no later than two years after it is earned. Upon termination, employees are paid for unused vacation at their current rates. Sick leave is accumulated at the rate of one day per month of employment. Unused sick leave is accumulated up to 80 days for employees. Unused accumulated sick leave is paid to employees who resign or retire, limited to 50 percent of days accumulated up to a maximum of 35 days. All vacation and sick pay is accrued when incurred in the government-wide and proprietary fund financial statements. The current portion of this liability is estimated based on historical trends. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Long-Term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities or proprietary fund type statement of net assets. Bond premiums and discounts as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Information

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. All annual appropriations lapse at fiscal year end.

The Village follows these procedures in establishing the budgetary information provided in the financial statements:

- a. Prior to the first Monday of January, the Village president submits to the Village Council a proposed operating budget for the year commencing the following March 1. The operating budget includes proposed expenditures and the means of financing them.
- b. Public hearings are conducted at the Village Hall to obtain taxpayer comments.
- c. Not later than the second Monday in February, the budget is legally enacted through passage of a resolution.
- d. Supplemental appropriations, when required to provide for additional expenditures, are matched by additional anticipated revenues or an appropriation of available fund balance and must be approved by the Village Council. All appropriations lapse at year end.

The appropriated budget is prepared by fund, function and department. The Village's department heads may make transfers of appropriations within a department. Transfers of appropriations between departments require the approval of the Village Council. The legal level of budgetary control is the department level. The Village Council made several supplemental budgetary appropriations throughout the year.

Excess of Expenditures Over Appropriations

During the year ended February 28, 2006, actual expenditures exceeded appropriations for police in the General Fund by \$5,331 and winter maintenance in the Local Streets Fund by \$8,537. These overexpenditures were funded with available fund balance.

NOTE C—DEPOSITS AND INVESTMENTS

Interest rate risk. The Village does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk. State law limits investments in commercial paper and corporate bonds to the two highest classifications issued by nationally recognized statistical rating organizations (NRSROs). The Village has no investment policy that would further limit its investment choices.

Concentration of credit risk. The Village does not have a concentration of credit risk policy. Concentration of credit risk is the risk of loss attributed to the magnitude of the Village investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized. The Village does not have any investments exposed to concentration of credit risk.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE C—DEPOSITS AND INVESTMENTS—Continued

Custodial credit risk – deposits. In the case of deposits, this is the risk that in the event of a bank failure, the Village's deposits may not be returned to it. As of February 28, 2006, \$2,015,330 of the Village's bank balance of \$2,343,936 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial credit risk – investments. The Village does not have a custodial credit risk policy for investments. This is the risk that, in the event of the failure of the counterparty, the Village will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Village does not have any investments exposed to custodial credit risk.

Foreign currency risk. The Village is not authorized to invest in investments which have this type of risk.

Restricted Assets

Restrictions are placed on assets by bond ordinance and Village Council action. At February 28, 2006, restricted cash in the Enterprise funds are restricted as follows:

Water Fund - Replacement	\$ <u>41,615</u>
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NOTE D—CAPITAL ASSETS

Capital asset activity for the year ended February 28, 2006 was as follows:

	Balance March 1, 2005	Additions	Deductions	Balance February 28, 2006
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 294,828	\$ 765	\$ -	\$ 295,593
Construction in progress	-	9,880	-	9,880
Total capital assets, not being depreciated	294,828	10,645	-	305,473
Capital assets, being depreciated:				
Buildings and improvements	439,140	-	-	439,140
Infrastructure	2,996,072	-	-	2,996,072
Vehicles and equipment	554,360	111,420	116,968	548,812
Total capital assets, being depreciated	3,989,572	111,420	116,968	3,984,024

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE D—CAPITAL ASSETS—Continued

	Balance March 1, 2005	Additions	Deductions	Balance February 28, 2006
Governmental activities:—Continued				
Less accumulated depreciation:				
Buildings and improvements	\$ 365,443	\$ 10,978	\$ -	\$ 376,421
Infrastructure	542,030	149,803	-	691,833
Vehicles and equipment	306,086	50,363	68,827	287,622
Total accumulated depreciation	<u>1,213,559</u>	<u>211,144</u>	<u>68,827</u>	<u>1,355,876</u>
Total capital assets, being depreciated, net	<u>2,776,013</u>	<u>(99,724)</u>	<u>48,141</u>	<u>2,628,148</u>
Capital assets, net	<u><u>\$ 3,070,841</u></u>	<u><u>\$ (89,079)</u></u>	<u><u>\$ 48,141</u></u>	<u><u>\$ 2,933,621</u></u>
Business-type activities:				
Capital assets, not being depreciated:				
Construction in progress	\$ -	\$ 111,923	\$ -	\$ 111,923
Capital assets, being depreciated:				
Plants and systems	4,135,793	12,500	21,166	4,127,127
Less accumulated depreciation:				
Plants and systems	<u>1,172,535</u>	<u>63,250</u>	<u>19,342</u>	<u>1,216,443</u>
Total capital assets, being depreciated, net	<u>2,963,258</u>	<u>(50,750)</u>	<u>1,824</u>	<u>2,910,684</u>
Capital assets, net	<u><u>\$ 2,963,258</u></u>	<u><u>\$ 61,173</u></u>	<u><u>\$ 1,824</u></u>	<u><u>\$ 3,022,607</u></u>

Depreciation expense has been charged to functions as follows:

Government activities:	
General government	\$ 10,485
Public safety	493
Public works	149,803
Internal Service Fund depreciation is charged to the various programs based on their usage of the assets	<u>50,363</u>
	<u><u>\$ 211,144</u></u>
Business-type activities:	
Sewer	\$ 19,827
Water	<u>43,423</u>
	<u><u>\$ 63,250</u></u>

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE E—BOND ISSUANCE COSTS

Bond issuance cost activity for the year ended February 28, 2006 was as follows:

	Balance March 1, 2005	Additions	Deductions	Balance February 28, 2006
Governmental activities:				
Bond issuance costs	\$ -	\$ 55,714	\$ -	\$ 55,714
Less accumulated amortization	<u>-</u>	<u>5,946</u>	<u>-</u>	<u>5,946</u>
Bond issuance costs, net	<u>\$ -</u>	<u>\$ 49,768</u>	<u>\$ -</u>	<u>\$ 49,768</u>
Business-type activities:				
Bond issuance costs	\$ 25,964	\$ -	\$ -	\$ 25,964
Less accumulated amortization	<u>3,137</u>	<u>1,298</u>	<u>-</u>	<u>4,435</u>
Bond issuance costs, net	<u>\$ 22,827</u>	<u>\$ (1,298)</u>	<u>\$ -</u>	<u>\$ 21,529</u>

Amortization

Amortization expense has been charged to functions as follows:

Governmental activities:	
Interest on long-term debt	\$ <u>5,946</u>
Business-type activities:	
Water	\$ <u>1,298</u>

NOTE F—INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

Advances to/from other funds:

The Equipment Fund advances to the Sewer Fund of \$40,000 represent an interfund loan used to pay for a hydro-geological study.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE G—LONG-TERM DEBT

Summary of Changes in Long-Term Liabilities

The following is a summary of long-term liabilities activity for the Village for the year ended February 28, 2006.

	Balance March 1, 2005	Additions	Reductions	Balance February 28, 2006	Due within one year
Governmental activities:					
General obligation bonds	\$ 1,410,000	\$ 1,325,000	\$ 1,285,000	\$ 1,450,000	\$ 95,000
Plus issuance premium	-	15,748	1,681	14,067	-
Less deferred amount on refunding	-	(70,034)	(7,474)	(62,560)	-
Compensated absences	106,866	44,591	47,557	103,900	45,000
Governmental activity long-term liabilities	<u>\$ 1,516,866</u>	<u>\$ 1,315,305</u>	<u>\$ 1,326,764</u>	<u>\$ 1,505,407</u>	<u>\$ 140,000</u>
Business-type activities:					
Revenue bonds	<u>\$ 1,255,000</u>	<u>\$ -</u>	<u>\$ 55,000</u>	<u>\$ 1,200,000</u>	<u>\$ 60,000</u>

Governmental activities:

General obligation bonds:

\$1,500,000 General Obligation Unlimited Tax
Bonds of 1997; final payment of \$50,000
due September 2006; interest at 5.30% \$ 50,000

\$175,000 Michigan Transportation Fund
bonds of 1999; payable in annual installments
of \$25,000 through September 2008;
interest at rates varying from 4% to 4.55% 75,000

\$1,325,000 Unlimited Tax General Obligation
Refunding Bonds of 2005; payable in annual
installments of \$20,000 to \$130,000 through
September 2019; interest at rates varying
from 2.4% to 4.25% 1,325,000

Plus issuance premium 14,067

Less deferred amount on refunding (62,560)

1,401,507

Compensated absences 103,900

\$ 1,505,407

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE G—LONG-TERM DEBT—Continued

Summary of Changes in Long-Term Liabilities—Continued

Business-type activities:

Revenue bonds:

\$1,365,000 Water Supply System Revenue

Bonds, Series 2002 due in annual installments
of \$60,000 to \$85,000 through October 2022;
interest at 2.5%

\$ 1,200,000

For governmental activities, claims and judgments and compensated absences are generally liquidated by the General Fund.

The general obligation bonds are backed by the full faith and credit of the Village.

In March 2005, the Village issued \$1,325,000 in Unlimited Tax General Obligation Bonds with interest rates from 2.4 percent to 4.25 percent to partially advance refund \$1,215,000 of outstanding General Obligation Unlimited Tax Bonds of 1997 with an interest rate varying from 5.3 percent to 5.85 percent. The net proceeds of approximately \$1,285,000 (after payment of \$56,000 in underwriting fees, insurance and other issuance costs) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for principal redemption and interest of the bonds listed above which are scheduled for maturity September 2008 and beyond. As a result, the General Obligation Unlimited Tax Bonds of 1997 are considered to be partially defeased and the liability for those bonds has been removed from long-term obligations.

The Village partially advance refunded the General Obligation Unlimited Tax Bonds of 1997 to reduce its total debt service payment over the next 14 years by approximately \$102,000 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of approximately \$82,000.

The Village was in compliance in all material respects with all the revenue bond ordinances at February 28, 2006.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE G—LONG-TERM DEBT—Continued

Summary of Changes in Long-Term Liabilities—Continued

Annual debt service requirements to maturity for debt outstanding as of February 28, 2006 follows:

Year ending February 28,	Governmental activities		Business-type activities	
	Principal	Interest	Principal	Interest
2007	\$ 95,000	\$ 50,873	\$ 60,000	\$ 30,000
2008	95,000	47,300	60,000	28,500
2009	100,000	44,219	60,000	27,000
2010	85,000	40,775	60,000	25,500
2011	85,000	38,225	65,000	24,000
2012-2016	550,000	143,001	340,000	95,250
2017-2021	440,000	32,936	385,000	50,500
2022-2023	-	-	170,000	6,375
Total	<u>\$ 1,450,000</u>	<u>\$ 397,329</u>	<u>\$ 1,200,000</u>	<u>\$ 287,125</u>

NOTE H—OTHER INFORMATION

Risk Management

The Village is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. The Village manages its liability and property risk by participating in Michigan Municipal Liability and Property Pool (MMLPP), a public entity risk pool providing property and liability coverage to its participating members. The Village pays an annual premium to MMLPP for its insurance coverage. The MMLPP is self-sustaining through member premiums and provides, subject to certain deductibles, occurrence-based casualty coverage for each incident and occurrence-based property coverage to its members by internally assuring certain risks and reinsuring risks through commercial companies. Various deductibles are maintained to place the responsibility for small charges with the insured. Settled claims resulting from these risks have not exceeded insurance coverage in any of the past three fiscal years.

The Village manages its workers' compensation risk by participating in the Michigan Municipal Workers' Compensation Fund (MMWCF), a public entity risk pool providing workers' compensation coverage to its participating members. The Village pays an annual premium to MMWCF for its workers' compensation coverage. The MMWCF is self-sustaining through member premiums and provides statutory workers' compensation coverage to its members by internally assuring certain risks and reinsuring risks through commercial companies. Settled claims resulting from these risks have not exceeded insurance coverage in any of the past three fiscal years.

The Village carries commercial insurance for employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Village of Shelby
NOTES TO FINANCIAL STATEMENTS
February 28, 2006

NOTE H—OTHER INFORMATION—Continued

Contingent Liabilities

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability to the applicable funds. The amount, if any, of expenditures that may be disallowed by the grantor cannot be determined at this time, although the Village expects such amounts, if any, to be immaterial.

NOTE I—PENSION PLAN

The Village provides pension benefits for all of its full-time employees through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the Plan plus investment earnings. The Plan is administered through Lincoln Financial Group, an independent third party. The Village and employees are required to contribute 4 percent and 2 percent, respectively, of the qualified employees' annual compensation each plan year. For the year ended February 28, 2006, pension expense was approximately \$12,400. Employee contributions were approximately \$9,700.

NOTE J—ECONOMIC DEPENDENCY

State of Michigan shared revenues represent 38 percent of General Fund revenues.

NOTE K—SUBSEQUENT EVENT

In June 2006, the Village purchased a new police car for \$16,771.

REQUIRED SUPPLEMENTARY INFORMATION

Village of Shelby
Required Supplementary Information
BUDGETARY COMPARISON SCHEDULE
General Fund
For the year ended February 28, 2006

	Budgeted amounts			Variance with final budget - positive (negative)
	Original	Final	Actual	
REVENUES				
Property taxes	\$ 275,000	\$ 275,000	\$ 295,486	\$ 20,486
Licenses and permits	50	50	-	(50)
Intergovernmental revenues - state	211,400	211,400	218,944	7,544
Charges for services	34,800	34,800	34,881	81
Fines and forfeitures	2,000	2,000	3,540	1,540
Investment earnings	15,500	15,500	17,195	1,695
Other	2,150	2,150	6,092	3,942
Total revenues	540,900	540,900	576,138	35,238
EXPENDITURES				
Current				
General government				
Village Council	6,940	6,940	5,469	1,471
Elections Commission	3,250	3,250	-	3,250
Village Clerk	28,262	30,751	25,486	5,265
Village Treasurer	18,042	18,042	13,303	4,739
Village hall/grounds	9,741	7,241	5,109	2,132
Other general government	37,800	37,163	29,886	7,277
Public safety				
Police Department	250,353	250,263	255,594	(5,331)
Public works				
Department of Public Works	239,797	239,770	212,209	27,561
Culture and recreation				
Parks	38,617	38,617	23,336	15,281
Capital outlay	-	765	765	-
Total expenditures	632,802	632,802	571,157	61,645
Net change in fund balance	\$ <u>(91,902)</u>	\$ <u>(91,902)</u>	4,981	\$ <u>96,883</u>
Fund balance at March 1, 2005			<u>705,762</u>	
Fund balance at February 28, 2006			<u>\$ 710,743</u>	

Village of Shelby
Required Supplementary Information
BUDGETARY COMPARISON INFORMATION
Major Streets Fund
For the year ended February 28, 2006

	Budgeted amounts			Variance with final budget - positive (negative)
	Original	Final	Actual	
REVENUES				
Intergovernmental revenues - state	\$ 135,000	\$ 135,000	\$ 144,965	\$ 9,965
Investment earnings	2,857	2,857	6,768	3,911
Other	-	-	98	98
Total revenues	137,857	137,857	151,831	13,974
EXPENDITURES				
Current				
Public works				
Routine maintenance	34,652	34,652	13,386	21,266
Traffic services	17,010	17,010	5,331	11,679
Winter maintenance	51,878	51,878	48,543	3,335
Administration	7,160	7,160	7,075	85
Debt service				
Principal	25,000	25,000	25,000	-
Interest and fees	4,700	4,700	4,169	531
Capital outlay	20,472	20,472	4,232	16,240
Total expenditures	160,872	160,872	107,736	53,136
Net change in fund balance	\$ <u>(23,015)</u>	\$ <u>(23,015)</u>	44,095	\$ <u>67,110</u>
Fund balance at March 1, 2005			<u>318,851</u>	
Fund balance at February 28, 2006			\$ <u>362,946</u>	

Village of Shelby
Required Supplementary Information
BUDGETARY COMPARISON SCHEDULE
Local Streets Fund
For the year ended February 28, 2006

	Budgeted amounts			Variance with final budget - positive (negative)
	Original	Final	Actual	
REVENUES				
Property taxes	\$ 67,000	\$ 67,000	\$ 73,697	\$ 6,697
Intergovernmental revenues - state	40,000	40,000	43,232	3,232
Investment earnings	4,100	4,100	9,393	5,293
Total revenues	111,100	111,100	126,322	15,222
EXPENDITURES				
Current				
Public works				
Routine maintenance	34,571	34,571	18,574	15,997
Traffic services	13,283	13,283	4,650	8,633
Winter maintenance	44,645	44,645	53,182	(8,537)
Administration	7,276	7,276	7,336	(60)
Capital outlay	30,670	30,670	5,648	25,022
Total expenditures	130,445	130,445	89,390	41,055
Net change in fund balance	\$ (19,345)	\$ (19,345)	36,932	\$ 56,277
Fund balance at March 1, 2005			420,922	
Fund balance at February 28, 2006			\$ 457,854	

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

July 5, 2006

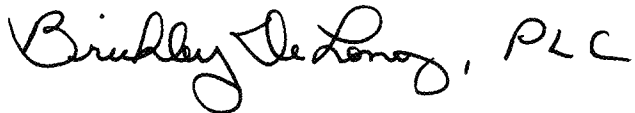
Village Council
Village of Shelby
Shelby, Michigan

In planning and performing our audit of the financial statements of the Village of Shelby for the year ended February 28, 2006, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Village of Shelby's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. We have attached a summary of such reportable conditions.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, none of the reportable conditions described above is believed to be a material weakness.

This report is intended solely for the information of the Village Council, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Brickley DeLong, PLC". The signature is written in a cursive, flowing style.

REPORTABLE CONDITIONS

Recommendation 1: All journal entries should have documented approval by an appropriate Village official.

During our testing, we noted that documented proper approval of journal entries did not exist for all journal entries.

The maintenance of files with documented approval of all journal entries would reduce the possibility of an inaccurate journal entry being made.

Recommendation 2: Internal controls should be strengthened by use of passwords for access to computers.

During our testing, we noted that computer passwords are not required in order to gain access to computer software programs. Open access to computer software could enable unauthorized use/manipulation of the computer system.

The required use of user passwords would help ensure only authorized access to sensitive computer software programs.

We consider the following reportable conditions contained in our June 27, 2005 letter as still applicable:

Recommendation 1: The internal control procedures should be further segregated within the utility record keeping function.

Recommendation 2: The compensated absence policy should be adhered to.